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The Supreme Court of California 1970-1971: Real Property Security

Charles R. Farrar Jr.

supreme court set to rest any doubts and upheld the practice. Defendant's expert there testified as to sales made after the date on which inclusion of defendant's parcel became reasonably probable and deducted amounts he felt were attributable to improper project enhancement.[87] The court upheld this practice because it felt it was "a most natural and, indeed, necessary component of the entire 'comparable sales' approach."[88] Furthermore, it held, such scaling does not conflict with the statute's objective of avoiding collateral issues that would prolong the trial.[89]

CONCLUSION

These three cases demonstrate that the California supreme court is adopting the progressive approach to eminent domain valuation that some commentators have advocated.[90] Its apparent focus on protecting the stability of the land market[91] seems calculated to serve important policy objectives, but the consequences of this approach, particularly in regard to depreciation of land values,[92] should be clarified. The flexible approach the court adopted towards comparable-sales evidence, granting wide discretion to the trial judge[93] and upholding scaling of comparable sales prices for comparison to the condemned parcel,[94] also promotes rational disposition of condemnation cases.

Richard Marcus

XII

REAL PROPERTY SECURITY

A. Due-on-Sale and Due-on-Encumbrance Clauses

La Sala v. American Savings & Loan Association.[1] In this case the

2d 889, 905, 63 Cal. Rptr. 640, 650 (4th Dist. 1967) (adjusting price for distance); City of San Diego v. Boggeln, 164 Cal. App. 2d 1, 7-8, 330 P.2d 74, 77-78 (4th Dist. 1958) (adjusting price to eliminate improper project enhancement); *cf.* People v. La Macchia, 41 Cal. 2d 738, 749, 264 P.2d 15, 23 (1953) (even when comparable sales are not allowed as independent evidence of value, experts can testify to distinguishing factors in sales they relied upon to form their opinions as to value).

87. 4 Cal. 3d at 502, 483 P.2d at 17, 93 Cal. Rptr. at 849.

88. *Id.* at 502, 483 P.2d at 17, 93 Cal. Rptr. at 849.

89. *Id.* at 501-03, 483 P.2d at 16-18, 93 Cal. Rptr. at 848-50.

90. *See* Anderson, *Consequences of Anticipated Eminent Domain Proceedings—Is Loss a Factor?*, 5 SANTA CLARA LAWYER 35, 42-47 (1964); Comment, *Recovery for Enhancement and Blight in California*, 20 HASTINGS L.J. 622, 648-49 (1969). *See generally* CAL. LAW REVISION COMM'N, *supra* note 15.

91. See text accompanying notes 59-62 *supra.*

92. See text accompanying notes 62-63 *supra.*

93. See text accompanying notes 80-84 *supra.*

94. See text accompanying notes 84-89 *supra.*

1. 5 Cal. 3d 864, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971) (Tobriner, J.) (6-1 decision).

supreme court found that enforcement of a due-on-encumbrance clause[2] in a deed of trust is an illegal restraint upon alienation when not reasonably necessary to protect the lender's security.[3] The case arose after the named plaintiffs had obtained secondary financing in violation of the due-on-encumbrance clause in their deed of trust. The clause specified that if the trustor sold or encumbered the property without the consent of the beneficiary (American), American could declare the entire note due and payable.[4] American notified each plaintiff that, if he did not pay a penalty and agree to increased interest rates, it would accelerate the notes due under the first deed of trust. The plaintiffs instituted a class action to enjoin American from enforcing the due-on-encumbrance clause and to obtain compensatory and punitive damages on behalf of all persons who executed deeds of trust containing such clauses in favor of American during the four years prior to the filing of the action.[5]

During pretrial proceedings American offered to waive enforce-

2. The court defined a due-on-encumbrance clause to be any clause providing for acceleration of the payments due under a deed of trust or mortgage should the borrower later encumber the property. Due-on-sale was defined as those clauses providing for acceleration upon sale only. *Id.* at 869, 489 P.2d at 1113, 97 Cal. Rptr. at 849. *La Sala* is the first case to use the "due-on-encumbrance" terminolgy, and only one other case has used "due-on-sale": Cherry v. Home Sav. & Loan Ass'n, 276 Cal. App. 2d 574, 580, 81 Cal. Rptr. 135, 138 (2d Dist. 1969). The use of the term due-on-sale in *Cherry* is consistent with the characterization used by the court in *La Sala,* since the clause under consideration there, arguably, did not make any provision for acceleration upon later encumbrance. *Id.* at 576, 81 Cal. Rptr. at 136; 5 Cal. 3d at 879 n.15, 489 P.2d at 1122 n.15, 97 Cal. Rptr. at 858 n.15. However, this is inconsistent with the terminology used by most commentators, who generally have referred to all such clauses as due-on-sale clauses, whether containing an encumbrance provision or not. *See, e.g.,* HETLAND, CALIFORNIA REAL ESTATE SECURED TRANSACTIONS § 4.55 (1970); Kolber, *The "Due-on-Sale" Clause in California,* L.A.B. BULL. 64 (1968). Under the court's classification almost all such clauses currently being used are due-on-encumbrance clauses and thus possibly subject to the reasonable-necessity standard [see text accompanying note 3 *infra*] regardless of how triggered. Probably that standard was only meant to apply when the clause, whatever it might be called, is triggered by the due-on-encumbrance provisiou. Possibly it would be better to refer to the total clause as an acceleration-option clause.

3. 5 Cal. 3d at 883-84, 489 P.2d at 1125-26, 97 Cal. Rptr. at 861-62; see notes 14-18 *infra* and accompanying text.

4. The clause used by American states:

> Should Trustor sell, convey, transfer, dispose of or further encumber said property, or any part thereof, or any interest therein, or agree to do so without the written consent of Beneficiary being first obtained, then Beneficiary shall have the right, at its option, to declare all sums secured hereby forthwith due and payable.

5 Cal. 3d at 869, 489 P.2d at 1115, 97 Cal. Rptr. at 851.

5. *Id.* at 870, 489 P.2d at 1116, 97 Cal. Rptr. at 852, The complaint excluded those persons making separate acknowledgments of the clause. *Id.* Possibly the reason for this exclusion was the reliance on the adhesion contract doctrine as an alternate cause of action. See notes 12-13 *infra* and accompanying text. The supreme court, however, made no mention of this exclusion in any of its discussions:

ment of the clause as to the named plaintiffs, and the trial judge then dismissed the action for lack of a proper plaintiff.[6] The propriety of this dismissal was the specific issue before the supreme court, which held that a named plaintiff who has obtained satisfaction from the defendant is not necessarily unfit to continue to represent the class; the trial court should have made a determination of the plaintiff's ability to represent the class fairly.[7] Furthermore, even if the trial court had found the plaintiffs unfit to represent the class, it should not have dismissed without notice to the class and permission to amend the complaint to provide a suitable representative.[8] The supreme court therefore reversed and remanded to the trial court for further proceedings.[9]

In addition to holding that the trial court erred in dismissing the class action, the court addressed three other issues raised by the defendant's pleadings and argued before the court: First, the court considered whether the action could be maintained at all, since the named plaintiffs had defined the class in such a way as to exclude themselves.[10] It concluded that dismissal would not be justified without leave to amend the pleadings.[11] Second, the court considered whether plaintiffs'

6. *Id.* at 870, 489 P.2d at 1116, 97 Cal. Rptr. at 852.

7. *Id.* at 871, 489 P.2d at 1116, 97 Cal. Rptr. at 852:

> When a plaintiff sues on behalf of a class, he assumes a fiduciary obligation to the members of the class, surrendering any right to compromise the group action in return for an individual gain. Even if the named plaintiff receives all the benefits that he seeks in the complaint, such success does not divest him of the duty to continue the action for the benefit of others similarly situated.

8. *Id.* at 871-73, 489 P.2d at 1117-18, 97 Cal. Rptr. at 853-54. There is no California requirement of notice following the dismissal of class actions generally, although there is for consumer class actions [CAL. CIV. CODE § 1781(f) (West Supp. 1971)], and stockholder's suits [Ensher v. Ensher, Alexander & Barsoom, Inc., 187 Cal. App. 2d 407, 410, 9 Cal. Rptr. 732, 734 (3d Dist. 1960)]. Nor is there a requirement of notice under the Federal Rules of Civil Procedure when dismissal is on the ground of impropriety of the suit as a class action. Nevertheless, where no determination was made at the commencement of the action as to the suitability of the plaintiffs, but only that plaintiffs were no longer proper after defendant's waiver, notice must now be given before dismissal.

9. 5 Cal. 3d at 873-74, 489 P.2d at 1118-19, 97 Cal. Rptr. at 854-55.

10. The named plaintiffs limited their class to persons borrowing from American within four years of the filing of the action [See text accompanying note 5 *supra*], but neither named plaintiff (the La Salas or Mrs. Iford) had obtained his loan within this time. The reason for this, according to the opinion, was that the plaintiffs' attorney "slavishly" followed the successful complaint in Daar v. Yellow Cab Co., 67 Cal. 2d 695, 433 P.2d 732, 63 Cal. Rptr. 724 (1967), overlooking the fact that the four-year statute of limitations runs from the breach of a written agreement rather than from its making. 5 Cal. 3d at 875 n.9, 489 P.2d at 1120 n.9, 97 Cal. Rptr. at 865 n.9.

11. 5 Cal. 3d at 874-76, 489 P.2d at 1119-20, 97 Cal. Rptr. at 855-56. The opinion stressed that a well-defined community of interest in the questions of law and fact was involved in this particular class, not "arbitrary" time limitations. See note 10 *supra*. Further, the community of interest in the *La Sala* action clearly extended over a period in excess of four years. Therefore, plaintiffs should have been allowed to amend their complaint.

reliance on the adhesion contract doctrine precluded bringing the action as a class action. The defendants argued that adhesion contract issues were inappropriate to a class action since they lacked the requisite community of interest. Although the court felt it would be premature to decide whether the present case would be suitable,[12] the opinion indicated that suits involving adhesion contracts might in fact be ideal for class actions, since they usually involve standard contracts and common questions of interpretation.[13] Finally, the court considered whether the due-on-encumbrance clause was a valid restraint on alienation.[14] The court found it would be valid only when its enforcement was reasonably necessary to protect the lender's security.[15] Such necessity is created when financing transactions resemble sales or, at least, where the borrower no longer has any incentive to maintain the property.[16] The court based this conclusion in part on Civil Code section 711[17] and in part on a line of cases involving the due-on-sale clause.[18]

Civil Code section 711 prohibits restrictions in transfers when they are "repugnant to the interest created."[19] This statute has been interpreted as voiding conditions in a deed of trust or mortgage that prohibit transfer of property held by the borrower in fee simple.[20] However, in *Coast Bank v. Minderhout*[21] the supreme court decided that

12. *Id.* at 883, 489 P.2d at 1125, 97 Cal. Rptr. at 861. The court reached this conclusion after it decided that the validity of the due-on-encumbrance clause depended upon the circumstances surrounding its enforcement. See notes 15-16 *infra* and accompanying text. Therefore, it was not clear, under the facts before it, "whether each class member must be considered individually, or whether they can be aggregated into a few subclasses sharing most issues of law and fact in common." *Id.* at 883, 489 P.2d at 1125, 97 Cal. Rptr. at 861.

13. *Id.* at 876-77, 489 P.2d at 1120-21, 97 Cal. Rptr. at 856-57.

14. *Id.* at 874, 489 P.2d at 1119, 97 Cal. Rptr. at 855.

15. *Id.* at 884, 489 P.2d at 1126, 97 Cal. Rptr. at 862.

16. The opinion indicates three instances in which the court felt that enforcement of a due-on-encumbrance clause would be reasonable: a conveyance to a mortgagee in possession; a second lien employed as a guise to effect a sale; and a bona fide loan leaving the owner with little equity in the property. 5 Cal. 3d at 881, 489 P.2d at 1124,, 97 Cal. Rptr. at 860.

17. CAL. CIV. CODE § 711 (West 1970).

18. See note 30 *infra.*

19. CAL. CIV. CODE § 711 (West 1970).

20. It has long been the common law rule that restrictions in a fee simple conveyance are void. Warton v. Mollinet, 103 Cal. App. 2d 710, 713, 229 P.2d 861, 863 (4th Dist. 1951); C. SMITH & R. BOYER, SURVEY OF THE LAW OF PROPERTY 34-35 (2d ed. 1971). California cases have established that attempts by a third party to restrict conveyance by contract would also be void as a restraint on alienation. Fritz v. Gilbert, 8 Cal. 2d 68, 71, 63 P.2d 291, 293 (1936); Prey v. Stanley, 110 Cal. 423, 426-27, 42 P. 908, 909 (1895). Thus, the restraint does not have to be in the deed itself. Coast Bank v. Minderhout, 61 Cal. 2d 311, 315-16, 392 P.2d 265, 268, 38 Cal. Rptr. 505, 508 (1964), was the first case to find restraints on alienation in contracts of mortgage and deeds of trust.

21. 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964).

section 711 does not automatically void a restraint; it can be enforced under certain circumstances when that restraint is reasonable.[22]

There the court dealt with an instrument providing that failure to obtain the lender's consent prior to transfer or further encumbrance would be considered a default[23] and that upon all defaults the lender had the right to accelerate as well as the right to "all other remedies and rights which it may have by law."[24] The court found the clause to be a restraint on alienation[25] but nevertheless permitted the lender to accelerate because in that case the restraint was reasonable.[26] The court also found that acceleration, when provided for in the instrument, was a more appropriate remedy than injunction, specific performance, or damages. The court indicated that the latter forms of enforcement might constitute an invalid restraint but reserved opinion since the issue was not before the court.[27] The opinion thus suggests that, at least in some instances, the method of enforcement and not the clause itself will determine whether there is an illegal restraint.

La Sala accepted this reasoning and declared that it was not the due-on-encumbrance clause itself but its enforcement, even by acceleration, apparently approved of in *Coast Bank*, that constituted the restraint.[28] This is important since it established that no explicit restraint, as in *Coast Bank*, need be within the clause for it to be invalid.[29]

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22. *Id.* at 316-17, 392 P.2d at 268, 38 Cal. Rptr. at 508. *Coast Bank* was heralded as a departure from the traditional rule, distinguishing California "as the first state not to invalidate a restraint on alienation when reasonable as to purpose." Comment, *Coast Bank v. Minderhout and the Reasonable Restraint on Alienation*, 12 U.C.L.A.L. REV. 954, 958 (1965). This statement is somewhat of an exaggeration, however, since Kentucky had apparently adopted the rule earlier. *See* Bernhard, *The Minority Doctrine Concerning Direct Restraints on Alienation*, 57 MICH. L. REV. 1173, 1176 (1959).

23. 61 Cal. 2d at 313 n.2, 392 P.2d at 266 n.2, 38 Cal. Rptr. at 506 n.2. The *La Sala* clause avoided the word "default." American also attempted to avoid the impression that its consent had to be given before sale or encumbrance. Basically, the clause provided only that if the borrower transferred, the seller could accelerate; acceleration, of course, is the remedy provided for most defaults. See note 4 *supra*.

24. 61 Cal. 2d at 313 n.2, 392 P.2d at 266 n.2, 38 Cal. Rptr. at 506 n.2.

25. See note 20 *supra* and accompanying text.

26. 61 Cal. 2d at 317, 392 P.2d at 268, 38 Cal. Rptr. at 508. However, the court did not specify what facts it premised the holding upon, nor did it indicate when it would find such a clause unreasonable.

27. *Id.* at 317, 392 P.2d at 268, 38 Cal. Rptr. at 508.

28. 5 Cal. 3d at 882, 489 P.2d at 1124, 97 Cal. Rptr. at 860.

29. See notes 23-24 *supra* and accompanying text. Following *Coast Bank*, commentators advised lenders that an agreement giving only the right to accelerate upon transfer would not be subject to challenge as a restraint upon alienation. HETLAND, *supra* note 2, § 4.56; Kolber, *supra* note 2, at 64. The commentators felt that if the lender did not make failure to obtain consent a default, the lender could condition continued extension of credit upon any circumstance it wished. This opinion was expressed in one California case:

Although the failure . . . to obtain . . . consent might give the lender the

However, the syllogism used by the court in reaching this conclusion creates doubt as to the status of the due-on-sale clause: *Coast Bank* validated only reasonable restraints and, together with several lower court cases following it,[30] held due-on-sale clauses valid; therefore, the *La Sala* court reasoned, if the justifications for upholding the due-on-sale clause were inapposite to enforcement of the due-on-encumbrance clause, that clause must be invalid as an unreasonable restraint on alienation.[31] But, by thus equating its concept of enforceability with the validity concept of prior cases, the court was led to conclude that the due-on-sale clause was automatically enforceable.[32] This conclusion was erroneous in that it is supported neither by the cited precedent[33] nor by reason.

Previous cases upholding the due-on-sale clause justified it for two reasons: First, the clause is necessary for the protection of the lender's security from excess depreciation or destruction. Risks are reduced if the lender has some measure of control over transfer of the property; thus, upon notification by the trustor (or mortgagor) of impending sale, the lender has the right to decide whether it wishes to continue to extend credit under changed circumstances.[34] Since a later encumbrance normally does not indicate change in possession, and the physical status of the security is therefore unchanged, the *La Sala* court found acceleration or penalty unjustifiable upon later encumbrance. The court recognized that a junior lien does increase the probability of future foreclosure, but it felt that the availability of acceleration upon sale would fully protect the lender.[35]

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right to accelerate the loan at its option, it in no way prevents the escrow from closing and in no manner restricts the trustor's right to alienate the property.

Moss v. Minor Properties, Inc., 262 Cal. App. 2d 847, 855, 69 Cal. Rptr. 341, 346 (2d Dist. 1968).

30. Cherry v. Home Sav. & Loan Ass'n, 276 Cal. App. 2d 574, 578-80, 81 Cal. Rptr. 135, 138-39 (2d Dist. 1969); Hellbaum v. Lytton Sav. & Loan Ass'n, 274 Cal. App. 2d 456, 458, 79 Cal. Rptr. 9, 11 (1st Dist. 1969); Jones v. Sacramento Sav. & Loan Ass'n, 248 Cal. App. 2d 522, 527 n.3, 56 Cal. Rptr. 741, 745 n.3 (3d Dist. 1967). The court distinguished approval of due-on-encumbrance provisions in *Hellbaum* [274 Cal. App. 2d at 458, 79 Cal. Rptr. at 11] and *Cherry* [276 Cal. App. 2d at 580, 81 Cal. Rptr. at 139] as "entirely dictum," pointing out that the act triggering acceleration in both of these cases was a sale, not an encumbrance, and only the validity of the due-on-sale clause was at issue. 5 Cal. 3d at 879, 489 P.2d at 1122, 97 Cal. Rptr. at 858.

31. 5 Cal. 3d at 879, 489 P.2d at 1122, 97 Cal. Rptr. at 858.

32. See note 42 *infra* and accompanying text.

33. *Id.*

34. Cherry v. Home Sav. & Loan Ass'n, 276 Cal. App. 2d 574, 578-79, 81 Cal. Rptr. 135, 138 (2d Dist. 1969); Hellbaum v. Lytton Sav. & Loan Ass'n, 274 Cal. App. 2d 456, 458, 79 Cal. Rptr. 9, 11 (1st Dist. 1969).

35. 5 Cal. 3d at 880, 489 P.2d at 1123, 97 Cal. Rptr. at 859.

The second justification for the due-on-sale clause is that it allows the lender to adjust interest rates upward to reflect current money market conditions. If interest rates decrease, the borrower will refinance with another lender; the acceleration-option clause allows the lender to do the same after sale or hypothecation.[36]

This distinction ignores the real issue. The lender is concerned that the borrower may waste the property and that, if he must foreclose, he will not be able to recover his investment. A bona fide purchaser is not necessarily less likely to maintain the property than the original owner. In fact, with rapidly rising land values, the buyer will sometimes have more equity in the property after sale than the seller had before, so that he has more incentive to maintain the property. The court recognized that in some cases an acceleration would be permissible if a later encumbrance leaves the borrower with little equity in the property;[37] it should also have recognized that the converse is possible after sale. Even in the more common situation, where the buyer has less equity than the seller, the lender should not be allowed to accelerate when investigation shows the buyer to be as responsible as the seller.[38]

The court dealt with this argument by stating in a footnote that, while allowing lenders to adjust interest rates upward to reflect tight-money conditions may be an appealing argument in a sale situation, it does not apply to a later encumbrance.[39] The argument lacked appeal because only in rare situations would the later encumbrance produce funds sufficient to allow the borrower to pay the debt if the lender accelerated,[40] while this would not be true following sale. But, in making this argument, the court ignored its own basic premise that the lender is seeking to adjust the interest rate upward to reflect the current market. The lender does not really want to foreclose; rather, he wants to force the borrower to refinance at the prevailing rate,[41] and the effect is exactly the same as if there had been a sale with a new

36. Cherry v. Home Sav. & Loan Ass'n, 276 Cal. App. 2d 574, 579, 81 Cal. Rptr. 135, 138 (2d Dist. 1969).

37. See note 16 *supra.*

38. Certainly, in instances where sale is by an individual to a major corporation for development purposes, the lender's security will not be endangered, yet acceleration with prepayment penalties could prevent the sale from closing. Even in the typical home sale, if the buyer is as responsible, financially and socially, as the seller, it is difficult to see why acceleration should be allowed. Furthermore, in many cases the seller will have no antideficiency protection; he will then continue to be liable for the unpaid balance. In these three cases it is reasonable to allow the lender to pass on only the costs of investigating the purchaser and doing the required paper work.

39. 5 Cal. 3d at 880 n.17, 489 P.2d at 1123 n.17, 97 Cal. Rptr. at 859 n.17.

40. *Id.*

41. See note 35 *supra* and accompanying text.

purchaser. Thus, this second justification is actually an argument for allowing variable-interest mortgages; it does not establish any real distinction between due-on-sale and due-on-encumbrance.

Nevertheless, because of the court's distinction between the two, it stated that although the due-on-sale clause might be subject to "automatic enforcement," the due-on-encumbrance clause could be enforced only when reasonably necessary to protect the lender's security.[42] This statement creates a misleading impression of the pre-*La Sala* state of the law. Neither *Coast Bank*[43] nor its progeny[44] found that the due-on-sale clause merited automatic enforcement. Rather, these cases at most determined the reasonableness of acceleration under particular circumstances. Since it is unlikely that the court meant to extend prior holdings on an issue not before it, the standard for enforcement of the due-on-sale clause becomes an open question. *La Sala*, itself, leads to the conclusion that the standard for enforcement of both clauses should be one of reasonableness, because the attempts to distinguish them merely emphasize their similarity.

Thus, although the court stated that the due-on-sale clause is automatically enforceable,[45] it may reach a different conclusion upon reexamination of the issue. The underlying reason for restricting the use of due-on-encumbrance clause applies also to the due-on-sale clause: the clause lends itself easily to abusive applications.[46] Fur-

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42. 5 Cal. 3d at 883, 489 P.2d at 1126, 97 Cal. Rptr. at 862. It is not certain what was meant by "automatic enforcement." Earlier in the opinion the court indicated that prior California cases had held the due-on-sale clause "clearly valid." *Id.* at 879, 489 P.2d at 1122, 97 Cal. Rptr. at 858. These cases, however, only found the clause enforceable to the extent that enforcement was reasonable, for an unreasonable clause is void under section 711. See notes 19-20 *infra* and accompanying text. *La Sala* purports to allow automatic enforcement because sale endangers the lender's security, which was the reason given for finding the clause itself valid. See text accompanying note 34 *infra*. Thus, it is not clear what the outcome would be should a lender accelerate when his security is clearly not in danger and he knows it.

43. See note 26 *supra* and accompanying text.

44. In none of the prior cases [see note 28 *supra*] has the reasonableness of the *enforcement* as a restraint on alienation been at issue; all considered instead the validity of the clause. *Hellbaum* did indicate that it would have considered such a contention had it been before the court. 274 Cal. App. 2d at 458-59, 79 Cal. Rptr. at 11. *Cherry* considered whether the lender was required to act reasonably in exercising its option to accelerate, but not because acceleration restrained alienation. Apparently the plaintiff there relied on a general doctrine of reasonableness in the performance of terms in a deed of trust, and the court ruled that there was no such doctrine. 267 Cal. App. 2d at 577, 81 Cal. Rptr. at 138.

45. See text accompanying note 42 *supra*.

46. 5 Cal. 3d at 880, 489 P.2d at 1123, 97 Cal. Rptr. at 859; *Id.* at 884, 489 P.2d at 1126, 97 Cal. Rptr. at 862. The primary abuse of the due-on-encumbrance provision is the extortion of high interest points and penalty payments as consideration for the lender's agreement not to accelerate. In *La Sala*, American asked for $150

thermore, reexamination will be necessary to determine what other transactions will be allowed to trigger acceleration. Examples of such transactions include a gift of the property in trust from father to minor child, a condemnation of part of the property, and a conveyance into joint tenancy following marriage. All of these would be covered by the clause used by American.[47]

In conclusion, *La Sala*'s finding that the due-on-encumbrance clause is enforceable only when reasonably necessary to protect the lender's security promises to have little effect upon the present practices of lenders. Certainly they will not change their forms because there will still be instances when the provision can be used.[48] Also, it is clear that this opinion does not give the borrower the right to encumber the property later without notifying the lender. At the very least the lender has the right to investigate the circumstances surrounding a junior encumbrance.

Jimmie Harris

B. Equitable Mortgages and the Homestead Exemption

Tahoe National Bank v. Phillips.[1] The court held that a standardized form providing for an assignment of rents and a covenant against conveyances of a person's residence, signed as security for a loan benefiting property distinct from that described in the form agreement, does not operate as an equitable mortgage having priority over a homestead declaration filed after the signing and recording of the form. This narrow holding, however, sharply contrasts with the court's circuitous reasoning, which threatens the continued viability of the doctrine of *Coast Bank v. Minderhout*[2] imposing an equitable mortgage on the property after a similar covenant against conveyances was breached.

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and an increase in interest from 6 to 9 percent from the La Salas and $50 and an increase from 6.6 to 8.75 percent from Iford. *Id.* at 870, 489 P.2d at 1116, 97 Cal. Rptr. at 852. Similar extortion could be used in the event of sale. In areas where market values are declining, the prospective buyer may refuse to pay the increased charges, and the seller must pay out of his equity or lose the sale.

47. See note 4 *supra.*

48. See note 16 *supra.*

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1. 4 Cal. 3d 11, 480 P.2d 320, 92 Cal. Rptr. 704 (1971) (Tobriner, J.) (6-1 decision).

2. 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964).

I. THE HOLDING AND THE COURT'S RATIONALE

Defendant Beulah F. Phillips was involved with three coventurers in a real estate development project in the Lake Tahoe area. The venture needed further capital, and plaintiff bank agreed to lend $34,000 to Phillips, who transferred the money to the venture's account, in return for Phillips' promissory note in that amount payable 1 month later. As security for the loan, Phillips executed and delivered an instrument assigning to the bank all rent due from the property described in the instrument and promising not to encumber or convey such property. The property described was not that involved in the real estate venture but rather Phillips' residence, which was unencumbered at that time. However, 9 months later Phillips recorded a homestead declaration on the property.[3]

The loan was never paid, and the bank brought suit on the note[4] asking for foreclosure, as an equitable mortgage, of the instrument providing for the assignment of rents and the covenant against conveyances. The trial court found that the assignment was an equitable mortgage and decreed its foreclosure. Defendant Phillips appealed this finding.

In holding for the defendant, the supreme court purported to follow the rule of *Pacific Gas & Electric Co. v. G.W. Thomas Drayage Co.*[5] that, with respect to the meaning of a written instrument, extrinsic evidence is admissible only to prove a meaning to which the language of the instrument is reasonably susceptible. After going through the agreement term by term, the court apparently concluded that the instrument, on its face, could not be construed as a mortgage, so that evidence purporting to show that the parties intended to execute a mortgage was legally irrelevant and inadmissible.[6] However, the court bolstered its parol-evidence-rule reasoning with the argument that, even if the instrument were ambiguous as to whether it was a mortgage, the adhesion contract doctrine required the ambiguity to be resolved against the drafter of the form agreement, especially since the drafter was in the superior bargaining position.[7] The headnote to this part of the opinion clearly manifests the court's uncertainty as to whether it was relying

3. 4 Cal. 3d at 14-15, 480 P.2d at 323-24, 92 Cal. Rptr. at 707-08.

4. At the time of the loan in question, the venture was already in debt to the bank on various notes and overdrafts, and the suit was on all of these in addition to the $34,000 loan. None of these other notes were involved in the decision, however.

5. 69 Cal. 2d 33, 37, 442 P.2d 641, 644, 69 Cal. Rptr. 561, 564 (1968).

6. 4 Cal. 3d at 16-19, 480 P.2d at 325-27, 92 Cal. Rptr. at 709-11. In *Coast Bank* a very similar instrument was held to be susceptible of interpretation as a mortgage, and *Tahoe Bank's* attempt to distinguish *Coast Bank* was cogently refuted by Justice Sullivan in dissent. *Id.* at 24-30 & n.5, 480 P.2d at 330-35 & n.5, 92 Cal. Rptr. at 714-19 & n.5.

7. *Id.* at 19-20, 480 P.2d at 327-28, 92 Cal. Rptr. at 711-12.

on the parol evidence rule or on adhesion contract reasoning: "The language of the assignment is not reasonably susceptible of interpretation as a mortgage *at the instance of plaintiff bank.*"[8]

In fact, the court's purported reliance on the parol evidence rule cannot be taken seriously. Often, in situations not involving homestead declarations, it is the borrower rather than the lender who claims that the instrument creates a mortgage.[9] Then, when the lender brings an ordinary contract action on the note, the borrower can raise the one-form-of-action defense[10] and claim the statutory protections of a mortgagor.[11] Thus, since *Coast Bank* the debtor has had a choice between defending directly such an action on the note and forcing the lender to follow the foreclosure procedures specified in the Code of Civil Procedure,[12] which, among other things, entitles the debtor to the statutory period of redemption.[13] However, the parol evidence rule of *Thomas Drayage* looks only to the language of the instrument itself to decide whether extrinsic evidence is admissible, and this language does not change depending on which party claims the instrument is a mortgage. The *Tahoe Bank* opinion does not discuss this point, but its heavily prodebtor orientation makes it extremely doubtful that the court intended to take this choice away from debtors whose situation is different from that of defendant Phillips. Therefore, in spite of the court's attempt to ground its decision in the parol evidence rule, it is really the unequal bargaining positions of the parties that is at the root of the court's reasoning, a conclusion adopted in a recent court of appeal decision.[14]

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8. *Id.* at 16, 480 P.2d at 325, 92 Cal. Rptr. at 709 (emphasis added).

9. Hetland, *Real Property and Real Property Security: The Well-Being of the Law*, 53 CALIF. L. REV. 151, 167-68 (1965).

10. CAL. CODE CIV. PRO. § 726 (West 1970).

11. *See generally* J. HETLAND, CALIFORNIA REAL ESTATE SECURED TRANSACTIONS §§ 2.39, 6.4-.12 (1970).

12. *E.g.*, CAL. CODE CIV. PRO. § 726 (West 1970) (one form of action, fair market value limitation on deficiency judgment, certain notice requirements).

13. *Id.* §§ 700a-707.

14. Kaiser Indus., Inc. v. Taylor, 17 Cal. App. 3d 346, 94 Cal. Rptr. 773 (1st Dist. 1971). The trial court in *Taylor* did not permit the borrower to raise the section 726 defense to the lender's action on the note. The court of appeal reversed, distinguishing *Tahoe Bank* on the ground that *Taylor* involved a private debtor and creditor relationship rather than an experienced lending institution and an individual borrower. The court further held that the evidence did not support the trial court's finding that the parties did not intend to create a mortgage. *Id.* at 351-52, 94 Cal. Rptr. at 775.

The agreement in Taylor involved a letter of instructions to a title company providing that the property could not be conveyed or encumbered without the creditor's consent. *Id.* at 350, 94 Cal. Rptr. at 774. Because the title company held the documents, it would be more difficult for the borrower to breach the *Taylor* agreement than either the *Coast Bank* or the *Tahoe Bank* agreement. The court of appeal felt that this difficulty-of-breach factor also made the *Taylor* agreement more reasonably susceptible

Even as a pure adhesion contract case, however, *Tahoe Bank* would represent an important extension of California law. The case is consistent with previous cases that have uniformly refused to enforce contracts on behalf of the superior bargaining party only when the contract was ambiguous.[15] However, as pointed out by Justice Sullivan in dissent,[16] none of the earlier cases involved an attempt to show the actual intent or understanding of the weaker party. In *Tahoe Bank* the supreme court did not attempt to weigh the extrinsic evidence or to say that the extrinsic evidence could not support a finding of actual intent by the borrower to create a mortgage; it held that the superior bargaining party could not prove such intent, at least under the facts of *Tahoe Bank*.[17] Read broadly, the case would not shield even a party who carefully explains and discusses the terms of the agreement with the weaker party from the possibility that a court might later find one of the terms to be ambiguous and therefore interpret it against the reasonable expectations of *both* parties. It is doubtful that the court intended to go so far; it did explicitly refuse to overrule *Coast Bank*, to which the adhesion contract argument applies as strongly. Furthermore, many previous opinions, including some written by Justice Tobriner, have emphasized the usefulness of form contracts, at least to the extent of enforcing them within the reasonable expectations of the parties.[18] Nevertheless, there is no way to limit these implications of *Tahoe Bank* under the court's approach. However, another rationale is available, although it was not mentioned by the court.

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of interpretation as a mortgage. *Id.* at 352, 94 Cal. Rptr. at 775. This distinction, however, also points in the other direction. If the *Coast Bank* and *Tahoe Bank* agreements are not mortgages, they are worthless to the creditor once the debtor has breached [see note 28 *infra*]; ease of breach therefore increases the probability of practical invalidation of the agreement. The *Taylor* agreement gives more assurance that, in practice, the debtor will have some assets available out of which the creditor can satisfy an ordinary judgment on the note; therefore, there is less need for the creditor to rely on the priority obtained from a recorded mortgage.

15. *E.g.*, Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966); Steven v. Fidelity & Cas. Co., 58 Cal. 2d 862, 377 P.2d 284, 27 Cal. Rptr. 172 (1962); Schmidt v. Pacific Mut. Life Ins. Co., 268 Cal. App. 2d 735, 74 Cal. Rptr. 367 (1st Dist. 1969); Ball v. California State Auto Ass'n Inter-Ins. Bureau, 201 Cal. App. 2d 85, 20 Cal. Rptr. 31 (1st Dist. 1962); Neal v. State Farm Ins. Co., 188 Cal. App. 2d 690, 10 Cal. Rptr. 781 (1st Dist. 1961). *But cf.* La Sala v. American Sav. & Loan, 5 Cal. 3d 864, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971).

16. 4 Cal. 3d at 30, 480 P.2d at 335, 92 Cal. Rptr. at 719.

17. *Id.* at 14, 480 P.2d at 323, 92 Cal. Rptr. at 707.

18. *E.g.*, Schmidt v. Pacific Mut. Ins. Co., 268 Cal. App. 2d 735, 737, 74 Cal. Rptr. 367, 369 (1st Dist. 1969); California School Employees Ass'n v. Willits Unified School Dist., 243 Cal. App. 2d 776, 787, 52 Cal. Rptr. 765, 771 (1st Dist. 1966); Ball v. California State Auto Ass'n Inter-Ins. Bureau, 201 Cal. App. 2d 85, 87-88, 20 Cal. Rptr. 31, 33-34 (1st Dist. 1962) (Tobriner, J.); Neal v. State Farm Ins. Co., 188 Cal. App. 2d 690, 694-97, 10 Cal. Rptr. 781, 784-85 (1st Dist. 1961) (Tobriner, J.).

II. A POSSIBLE RATIONALE

Tahoe Bank can be distinguished from *Coast Bank* in two important respects: First, the *Coast Bank* loan was for the improvement of the property described in the covenant not to convey,[19] and under these circumstances it is arguably reasonable for a court to impose an equitable mortgage on the improved property with priority over the rights of subsequent purchasers or mortgagees. Theoretically, the increased value of the property due to the improvement is directly traceable to the loan in question, so it seems fair to allow the lender a prior stake in such increased value, especially since recording the instrument gives subsequent purchasers constructive notice of the loan and its purpose. However, it should be observed that, to the extent this argument is accepted, the lender should not have to wait until the agreement is breached through the borrower's sale of the property to obtain a judicial declaration of his rights as an equitable mortgagee; such a remedy should be available at any time in a quiet title action.

The second important distinction between the two cases is that in *Coast Bank* the borrower actually breached his agreement not to convey by selling the property to a third party, the defendant Minderhout. The *Coast Bank* court felt it would have difficulty specifically enforcing such an agreement by enjoining the borrower from selling,[20] and had the court not allowed foreclosure of the lender's security interest in effect there would have been a complete invalidation of the instrument.[21] In *Tahoe Bank*, on the other hand, there was no sale of the property covered by the agreement; rather, the borrower filed a homestead declaration but only after the lender had recorded the borrower's covenant not to convey.[22] The dissent in *Tahoe Bank* vigorously ar-

19. This is not entirely clear from the *Coast Bank* opinion itself. The agreement, which the court reproduced in a footnote, does have a parenthetical in its title saying that it is "[f]or use with Property Improvement Loan," but it also says that the promise was made "[i]n consideration of *any* loan or advance" made by the bank and that the property described would not be sold "until all such loans and advances and *all other indebtedness*" to the bank had been paid. 61 Cal. 2d at 313 n.2, 392 P.2d at 266 n.2, 38 Cal. Rptr. at 506 n.2 (emphasis added). This was pointed out by Justice Sullivan in his *Tahoe Bank* dissent. 4 Cal. 3d at 31, 480 P.2d at 336, 92 Cal. Rptr. at 720. However, the *Tahoe Bank* majority did assume that the *Coast Bank* loan was intended to improve the property described in the agreement [*id.* at 20, 480 P.2d at 328, 92 Cal. Rptr. at 712], and this may be important in understanding the *Tahoe Bank* opinion.

20. 61 Cal. 2d at 317, 392 P.2d at 268, 38 Cal. Rptr. at 508.

21. Tahoe Nat'l Bank v. Phillips, 4 Cal. 3d at 21, 480 P.2d at 328, 92 Cal. Rptr. at 712.

22. *Id.* at 15, 480 P.2d at 324, 92 Cal. Rptr. at 708. It should be observed that, in some cases, a homestead can be filed by a person other than the covenantee. For example, a husband may be the covenantee, and the Civil Code permits the wife to file a homestead declaration if the husband fails to do so. CAL. CIV. CODE § 1262 (West 1970). Absent some form of collusion, there would be no breach in such a case.

gued that, while a homestead declaration is not an encumbrance for other purposes, it should be considered an encumbrance in this case because the very purpose of the agreement not to convey or further encumber was to keep the property available for execution after the creditor obtains a judgment on the debt.[23] Indeed, the majority completely failed to meet this argument regarding the parties' intent, mechanically disposing of the question in a footnote that relied on language from cases stating that a homestead is not an encumbrance for various other purposes.[24]

Nevertheless, the majority may have been implicitly relying on a much stronger rationale for its position: the statutory policy exempting homesteads from execution except under specifically enumerated circumstances.[25] It is true that subsection 4 of the exception section, Civil Code section 1241,[26] subjects a homestead to execution in satisfaction of a judgment on a debt secured by an encumbrance on the premises recorded before the filing of the homestead declaration, so the meaning of the word "encumbrance" is again the issue. However, it is not only the parties' intent which must be ascertained to determine whether their agreement would be breached by a homestead declaration, that must be determined; the more important question is whether the legislature intended such an agreement not to convey or encumber to be an encumbrance within the meaning of section 1241. Thus, the court could have come to the *Tahoe Bank* result through a strict construction of the statute in favor of the homestead exemption. Of course, if this reasoning were adopted it would apply equally where the loan was for the improvement of the property covered by the agreement not to convey and even to the case in which the lender seeks to obtain an equitable mortgage on the property through judicial decree in a quiet title action: neither the agreement nor the equitable mortgage should be considered an encumbrance under section 1241 because the policy protecting the homestead remains as strong as it is under the *Tahoe Bank* facts.[27]

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23. 4 Cal. 3d at 31-32, 480 P.2d at 336, 92 Cal. Rptr. at 720.

24. *Id.* at 21 n.14, 480 P.2d at 328 n.14, 92 Cal. Rptr. at 712 n.14.

25. CAL. CIV. CODE § 1240 (West 1970).

26. *Id.* § 1241.

27. Even an attachment lien, to the extent that it remains available after Randone v. Appellate Dep't of the Superior Court, 5 Cal. 3d 565, 488 P.2d 1, 96 Cal. Rptr. 697 (1971), is extinguished by a subsequent homestead declaration. Yager v. Yager, 7 Cal. 2d 213, 217, 60 P.2d 422, 424 (1936). The purpose of the covenant not to convey is to ensure that property is available for execution after a judgment is obtained, which is identical to the function of the attachment lien.

An interesting question arises in the *Tahoe Bank* situation if the debtor sells the property after filing the homestead declaration. *Coast Bank* says that, without the homestead declaration, the recorded covenant against conveyances signed by the seller is enforceable as an equitable mortgage against the purchaser. The lien of this mortgage will extend to the full value of the property if the loan was greater than such

CONCLUSION

If the crucial difference between *Tahoe Bank* and *Coast Bank* is whether the loan was made for the improvement of property described in the agreement, *Tahoe Bank* will have some important ramifications. Where the loan was made for the improvement of distinct property, borrowers who hold outstanding loans under such agreements would be able to further encumber or sell with the new interest in the property having priority over the loan.[28] However, the *Tahoe Bank* majority stated that the borrower's having actually breached the agreement in *Coast Bank* was the factor of "greater significance."[29] Although the court did not satisfactorily support its claim that there was no breach under the *Tahoe Bank* facts, this statement emphasizes the importance that the homestead declaration played in the decision. Therefore, the best interpretation of *Tahoe Bank* is that it reaffirms a strict construction of the homestead statutes in favor of the exemption and implies that a quiet title action by the lender to establish his mortgage does not lie until there is a breach of the agreement by the borrower.

Dennis S. Karjala

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value. The question is whether the filing of the homestead declaration by the seller makes any difference in the position of the purchaser.

This problem, too, is probably best analyzed by analogy to the attachment lien. It appears to be settled California law that an attachment lien extends only to the excess of value over the amount allocable to the homestead exemption. In Southern Pac. Milling Co. v. Milligan, 15 Cal. 2d 729, 104 P.2d 654 (1940), the supreme court upheld the trial court's order releasing the lien of an attachment in a contract action because plaintiff had filed an affidavit claiming that the amount of the homestead exemption plus the amount of existing encumbrances exceeded the value of the property; since defendant had offered no evidence to the contrary, there was no excess value for the lien to attach to. *Id.* at 730-31, 104 P.2d at 655. *Accord*, Zimberoff v. Bank of America Nat'l Trust & Sav. Ass'n, 112 Cal. App. 2d 555, 558, 246 P.2d 961, 962-63 (2d Dist. 1952) (dictum). Presumably, the defendant in *Milligan* could have then sold the property, and the purchaser would not have been subject to the lien since it was dissolved. The similarity of purpose between the covenant in *Tahoe Bank* and an attachment lien argues that, once the homestead declaration is filed in the *Tahoe Bank* situation, any subsequent lien impressed as a result of the covenant against conveyances can attach only to the excess over the amount of the declarant's homestead exemption. In fact, the covenant may be viewed as a pre-cause-of-action attachment; therefore, there is no reason to favor the holder of the lien of the covenant over an ordinary attachment lienor.

28. This approach to the problem renders the agreement totally meaningless where the loan was made for purposes other than to improve the property described in the agreement. Unless the agreement is enforceable as a mortgage, so that it encumbers and allows the lender to satisfy a subsequent judgment out of the property, it is worthless to the lender because the lender's maximum damages for breach of the agreement are the same as he would recover in an action on the note itself. J. HETLAND, *supra* note 11, at § 2.38.

29. 4 Cal. 3d at 20-21, 480 P.2d at 328, 92 Cal. Rptr. at 712.

C. *Land Sale Contracts*

MacFadden v. Walker.[1] The court held that a willfully defaulting vendee was entitled to specific performance of an installment land sale contract where it would not be unfair to the vendor.[2] The decision is the latest in a series of cases[3] in which the supreme court has reformed the law of installment land contracts,[4] liberalizing, in particular, the treatment of defaulting vendees.

I. THE MACFADDEN DECISION

In 1953, Claudia Walker entered into a written contract to purchase 80 acres of unimproved property in Placer County from Ellsworth MacFadden. The purchase price was $2,484.50, payable in monthly installments of $20. The contract also provided that if Walker defaulted, MacFadden could terminate her rights under the contract and retain any payments made as the reasonable value for the use of the property.[5] Walker made all payments through November 1, 1963, a total of $2,500. At this point she discovered that timber had been taken off the land and made no further payments. In May 1964 MacFadden mailed notice of termination of Walker's rights, although Walker testified that she had not received this notice. Finally, in May 1966 MacFadden filed an action to quiet title. After Walker's offer to pay the entire principal balance with compound interest was rejected, she cross-complained for specific performance and paid the unpaid principal with interest into the court.[6]

The trial court found Walker's breach was not willful because of the dispute over the timber taken from the property, and she was granted specific performance.[7]

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1. 5 Cal. 3d 809, 488 P.2d 1353, 97 Cal. Rptr. 537 (1971) (Wright, C.J.) (unanimous decision).

2. *Id.* at 814-15, 488 P.2d at 1356-57, 97 Cal. Rptr. at 540-41.

3. Honey v. Henry's Franchise Leasing Corp., 64 Cal. 2d 801, 415 P.2d 833, 52 Cal. Rptr. 18 (1966); Freedman v. Rector, 37 Cal. 2d 16, 230 P.2d 629 (1951); Barkis v. Scott, 34 Cal. 2d 116, 208 P.2d 367 (1949). *See also* Ward v. Union Bond & Trust Co., 243 F.2d 476 (9th Cir. 1957) (interpreting and applying California law).

4. *See* J. HETLAND, CALIFORNIA REAL ESTATE SECURED TRANSACTIONS §§ 3.1-3.81 (1970) [hereinafter cited as HETLAND]; Hetland, *Real Property and Real Property Security*, 53 CALIF. L. REV. 151 (1965); Hetland, *The California Land Contract*, 48 CALIF. L. REV. 729 (1960). *See also* Warren, *California Installment Land Sale Contracts*, 9 U.C.L.A.L. REV. 608 (1962); 10 STAN. L. REV. 355 (1958).

5. 5 Cal. 3d at 811, 488 P.2d at 1354, 97 Cal. Rptr. at 538. In addition, Walker had the right to prepay all or any part of the unpaid balance, while no timber could be removed from the property without MacFadden's consent.

6. *Id.* at 812, 488 P.2d at 1354, 97 Cal. Rptr. at 538.

7. The grant of specific performance was based on Civil Code section 3275, which provides:

The supreme court concluded that Walker, the vendee, had not sustained the burden of proving her breach was not willful;[8] therefore, she was not entitled to relief from forfeiture under Civil Code section 3275.[9] The court then turned to the question whether specific performance was available to a willfully defaulting vendee. *In Freedman v. Rector*[10] the California supreme court had held that section 3275 was not the exclusive means of relief from forfeiture, and that several sections of the Civil Code [11] taken together established a policy against upholding forfeitures that have no reasonable relation to the damage caused by even a willful vendee's breach.[12]

The *Freedman* holding was limited to monetary restitution, but *MacFadden* found the antiforfeiture policy equally applicable when a willfully defaulting vendee sought specific performance.[13] To justify its conclusion the court quoted at length from *Barkis v. Scott*,[14] pointing out that permitting the defaulting vendee to reinstate may often be the fairest approach, because restitution of the excess of payments over the vendor's damages may still result in a forfeiture if the vendee's rights under the contract are foreclosed.[15]

The court then turned to MacFadden's contention, based upon *Honey v. Henry's Franchise Leasing Corp.*,[16] that the decision to rescind or enforce the contract is exclusively the vendor's.[17] The

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> Whenever, by the terms of an obligation, a party thereto incurs a forfeiture, or a loss in the nature of a forfeiture, by reason of his failure to comply with its provisions, he may be relieved therefrom, upon making full compensation to the other party, except in case of a grossly negligent, willful, or fraudulent breach of duty.

CAL. CIV. CODE § 3275 (West 1970). The Third District court of appeal reversed, holding that the evidence did not support the trial court's finding of a dispute between the parties. Therefore, Walker's breach was willful, and she was not entitled to relief under section 3275. 92 Cal. Rptr. 406, 408-11 (Cal. App., 3d Dist. 1971).

8. 5 Cal. 3d at 813, 488 P.2d at 1355, 97 Cal. Rptr. at 539.

9. *Id.* at 813-14, 488 P.2d at 1355-56, 97 Cal. Rptr. at 539-40. See text accompanying notes 24-56 *infra*.

10. 37 Cal. 2d 16, 230 P.2d 629 (1951).

11. CAL. CIV. CODE §§ 3294, 1670, 1671, 3369 (West 1970).

12. *See* 5 Cal. 3d at 813-14, 488 P.2d at 1355-56, 97 Cal. Rptr. at 539-40.

13. *Id.* The court cited Ward v. Union Bond & Trust Co., 243 F.2d 476 (9th Cir. 1957), as in accord and referred to Professor Hetland's *California Real Estate Secured Transactions* § 3.60 [see note 4 *supra*], which states, "The present California position probably is that the buyer has the right to reinstate the contract whether his default was willful or nonwillful." HETLAND § 3.60, at 105.

14. 34 Cal. 2d 116, 208 P.2d 367 (1949).

15. 5 Cal. 3d at 814, 488 P.2d at 1356, 97 Cal. Rptr. at 540.

16. 64 Cal. 2d at 804, 415 P.2d at 835, 52 Cal. Rptr. at 20. The court of appeal used this argument in reversing the trial court's judgment for Walker. 92 Cal. Rptr. at 410-11.

17. 64 Cal. 2d at 804, 415 P.2d at 835, 52 Cal. Rptr. at 20. The *Honey* opinion states:

> When a vendee has materially breached his contract, the vendor has an election to rescind or enforce the contract. The defaulting vendee, however, has

court's answer was that in *Honey* neither party requested specific performance. "Therefore, the language in Honey was directed only to whether the vendee, by deciding to rescind or enforce the contract, could dictate the measure of damages and determine the amount of restitution." Thus, the court concluded, *Honey*'s language only applies to the determination of damages and does not preclude granting a willfully defaulting vendee specific performance.[18]

In an attempt to put a further gloss on its decision, the court added two full paragraphs at the ends of its opinion that are almost obvious appendages.[19] In the first paragraph the court emphasized that the remedy granted Walker—specific performance to a willfully defaulting vendee—is an equitable remedy that must also protect the vendor.[20] The court then characterized the default as "the petulant reaction of an elderly lady to an apparent theft of timber from her property" and chided the vendor for his lack of diligence in bringing the quiet title action, implying that he may have been waiting on market developments.[21] Thus, the court hedged its finding of willfulness and undercut a potential claim by MacFadden that Walker lacked clean hands.

In the next paragraph, the court noted Professor Hetland's "persuasive" arguments that installment land sale contracts should be treated as security devices, which allow opportunity for a willfully defaulting debtor to cure his default.[22] The court refused to consider

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no such election. Otherwise, the contract of sale would in effect be a lease with an option to purchase. The vendee would receive the benefit of any increase in the value of the property, and the vendor would bear the entire risk of any decrease in its value. Such protection to a defaulting vendee would go beyond that provided by anti-deficiency legislation, which places the risk of depreciation in valne on the vendor only to the extent that the value of the property may decrease below the amount still owing on the contract.

Id. (citations omitted).

18. 5 Cal. 3d at 815, 488 P.2d at 1356, 97 Cal. Rptr. at 540.

19. 5 Cal. 3d at 815-16, 488 P.2d at 1356-57, 97 Cal. Rptr. at 540-41. Professor Hetland appeared at oral argument as amicus curiae on behalf of Walker, the vendee, and did not participate in the preparation of briefs. Only after argument did Professor Hetland submit, with the court's permission, a supplemental memo, outlining his position and calling the conrt's attention to the "Land Contract" chapter of *California Real Estate Secured Transactions*. *See* Letter from John R. Hetland to Donald O. Wright, September 8, 1971 (filed with supreme court briefs in *MacFadden v. Walker* Sac. No. 7894).

20. 5 Cal. 3d at 815, 488 P.2d at 1356-57, 97 Cal. Rptr. at 540.

21. *Id.*, 488 P.2d at 1357, 97 Cal. Rptr. at 541.

22. The court stated:

> Finally, we note again, as we also did in the *Honey* case, Professor Hetland's persuasive arguments that installment land sale contracts should be treated as security devices substantially on a par with mortgages and deeds of trust, and that therefore "the law governing those security devices shonld be adopted with appropriate modifications in determining the remedies for breaches of installment contracts." (*Honey v. Henry's Franchise Leasing*

these arguments, however, concluding that it need not decide what other remedy Walker might be entitled to as she had already been granted the relief sought—specific performance.[23] Taken together these paragraphs raise the issue of the extent to which the court has accepted Professor Hetland's views, and this in turn will determine *MacFadden*'s implications. Resolution of the issue requires an examination of *MacFadden* as part of the series of cases that affected its result.

II. FROM BARKIS TO HONEY

Barkis v. Scott[24], on which the court placed so much reliance, marked the beginning of a series of cases that has reformed the law of land sale contracts.[25] *Barkis* involved a long-term installment contract, similar to the one in *MacFadden*. Over a period of four years the vendee had made 57 monthly payments, but he defaulted on two payments when his bank refused to honor his personal checks. The vendor declared a forfeiture under the contract's forfeiture clause and sued to quiet title.[26]

The supreme court reversed the trial court's judgment for the plaintiff-vendor, holding the defaulting vendee could avoid a forfeiture and obtain relief under Civil Code section 3275.[27] In reaching this result the court determined the vendee's breach was nonwillful[28] despite ample evidence supporting the trial court's finding of willfulness.[29]

The significance of the *Barkis* decision is twofold. First, since the facts supported the trial court's finding of a willful breach, *Barkis* served notice that a willfully defaulting vendee might receive similar

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Corp., supra, 64 Cal. 2d 801, 804; see Hetland, California Real Estate Secured Transactions, *supra,* §§ 3.58-3.81, pp. 100-134.) That law affords even the willfully defaulting debtor an opportunity to cure his default before losing his interest in the security. (See Hetland, *supra,* § 3.60, pp. 105-106; see also *Petersen v. Ridenour* (1955) 135 Cal. App. 2d 720, 728 [287 P.2d 848].) Since we have concluded, however, that Mrs. Walker is entitled to the remedy of specific performance, we need not decide whether she might also be entitled to some other remedy under the law governing security transactions.

5 Cal. 3d at 816, 488 P.2d at 1357, 97 Cal. Rptr. at 541.

23. *Id.*

24. 34 Cal. 2d 116, 208 P.2d 367 (1949).

25. See note 4 *supra.*

26. 34 Cal. 2d at 117-18, 208 P.2d at 368.

27. *Id.* at 123, 208 P.2d at 371. *See* CAL. CIV. CODE § 3275 (West 1970), reproduced in note 7 *supra.*

28. 34 Cal. 2d at 123, 208 P.2d at 371-72.

29. *Id.* at 124, 208 P.2d at 372 (dissenting opinion). Professor Hetland strongly emphasizes the oddity of this factual determination and its import. Hetland, *Real Property and Real Property and Real Property Security, supra* note 4, at 154-55.

relief from forfeiture.[30] Second, in a separate discussion of the situation where the defaulting vendee wishes to reinstate the contract, the court expressed a preference for this remedy over cancelling the contract and returning to the vendee the excess of his payments over the vendor's damages. The court's main objection to the latter remedy was that frequently vendees were unable to prove vendors' damages, even at times when such damages were minimal, and that, failing to meet this burden, the vendees were unable to show any excess of payments over vendors' damages; therefore, they failed to obtain any restitution.[31] This discussion of remedies also proved to be a warning[32] of impending changes in land sale contracts.[33]

The next major case in the series, *Freedman v. Rector*,[34] was decided two years after *Barkis*. In *Freedman* the vendee paid $2,000 on a deposit agreement.[35] He then repudiated the agreement, claiming the title was not clear. Before the parties could reach any new agreement the vendor cancelled the escrow and later sold the property to a third party for $2,000 more than the price originally agreed upon. The original vendee then sued the vendor for specific performance.[36]

The court denied the vendee specific performance on the ground that he had expressly repudiated the contract,[37] but of equal importance was the fact that the property had been conveyed to a third party.[38] The court did avoid a forfeiture, however, and granted the vendee restitution of his payments over the vendor's damages.[39] Since the default was willful,[40] the court was unable to rely on Civil Code section 3275 for relief from forfeiture.[41] Therefore, the court relied instead on intimations in an earlier case[42] and construed four sections

30. *See* Hetland, *Real Property and Real Property Security, supra* note 4, at 154-55.

31. 34 Cal. 2d at 121-22, 208 P.2d at 370-71.

32. *See* Hetland, *Real Property and Real Property Security,* supra note 4, at 154-55.

33. The *Barkis* remedy language was quoted by the *MacFadden* court. 5 Cal. 3d at 814, 488 P.2d at 1356, 97 Cal. Rptr. at 540.

34. 37 Cal. 2d 16, 230 P.2d 629 (1951).

35. *Id.* at 18, 230 P.2d at 630. Note the distinction between the deposit agreement, essentially a marketing device, and the long-term installment sales contract, essentially a security device. HETLAND § 3.59; Hetland, *The California Land Contract, supra* note 4, at 729-30, 759-60.

36. 37 Cal. 2d at 18, 230 P.2d at 630.

37. *Id.* at 19, 230 P.2d at 631.

38. *See* HETLAND § 3.74.

39. 37 Cal. 2d at 23, 230 P.2d at 632-33.

40. *Id.* at 20, 230 P.2d at 631.

41. *Id.*

42. Baffa v. Johnson, 35 Cal. 2d 36, 216 P.2d 13 (1950). See the discussion of *Baffa* in Hetland, *Real Property and Real Property Security, supra* note 4, at 155.

of the Civil Code[43] as expressing a policy against forfeiture, regardless of willfulness.[44]

Between *Freedman* and *MacFadden*, two crucial decisions were rendered: *Ward v. Union Bond & Trust Co.*[45] and *Honey v. Henry's Franchise Leasing Corp.*[46] Both had significant impact on the outcome of *MacFadden* and will help determine its implications.

In *Ward* the Ninth Circuit granted a willfully defaulting vendee specific performance of his installment land sale contract.[47] After paying most of the purchase price and making improvements on the land the vendee was allowed to cure his willful default by paying the full purchase price with damages and interest. This relief was granted despite the vendor's argument that the vendee's relief was limited to restitution of the excess of his payments over the vendor's damages.[48]

Since the vendee initiated the action by seeking specific performance,[49] *Ward* implies that a willfully defaulting vendee need not wait for the vendor to institute quiet title action before asserting his right to reinstate the contract.[50] However, this question remains open, even after *MacFadden*, since no vendee-initiated action has appeared in the state courts.[51] Finally, *Ward* raises the possibility that the vendee could compel a judicial sale of the property as an alternative to reinstating the contract. Affirming the trial court's disposition of the case, the *Ward* court stated, "The Court might have well ordered a judicial sale upon foreclosure and further protected . . . [the vendee's] equity with right of redemption."[52] Judicial accept-

43. CAL. CIV. CODE §§ 3294, 1670, 1671, 3369 (West 1970).

44. 37 Cal. 2d at 22-23, 230 P.2d at 632-33. The court used precisely this policy to grant Walker specific performance in *MacFadden:* "We believe that the anti-forfeiture policy recognized in the *Freedman* case also justifies awarding even wilfully defaulting vendees specific performance in proper cases." 5 Cal. 3d at 814, 488 P.2d at 1356, 97 Cal. Rptr. at 540. This result was predicted. Ward v. Union Bond & Trust Co., 243 F.2d 476 (9th Cir. 1957); *see* HETLAND § 3.60; Hetland, *Real Property and Real Property Security, supra* note 4, at 156: Hetland, *The California Land Contract, supra* note 4, at 734-35, 762-66. *Contra,* 10 STAN. L. REV. 355, 360-61 (1958).

45. 243 F.2d 476 (9th Cir. 1957).

46. 64 Cal. 2d 801, 415 P.2d 833, 52 Cal. Rptr. 18 (1966).

47. 243 F.2d at 480-81.

48. *Id.* at 478-80. The vendor was willing to make such restitution if shown. *Id.* at 479. *See also* Hetland, *The California Land Contract, supra* note 4, at 734-35, 35 n.33, 762-66.

49. The vendor cross-complained for damages and quiet title. *Id.* at 478.

50. *See* Hetland, *The California Land Contract, supra* note 4, at 764.

51. Similarly, the question remains whether the reinstatement allowed the defaulting vendee under the installment contract requires accelerated payments or simply tendering arrearages and expenses and continuing payments under the contract. *See* Hetland, *The California Land Contract, supra* note 4, at 765-66. *See also* Petersen v. Ridenour, 135 Cal. App. 2d 720, 287 P.2d 848 (2d Dist. 1955).

52. 243 F.2d at 481. *See* HETLAND § 3.77-3.78; Hetland, *The California Land Contract, supra* note 4, at 766-68.

ance of this remedy requires a remedial equation of installment land sale contracts with other security devices, and although *MacFadden* did not make this equation explicit, it may be inferred from the opinion.[53]

Honey, decided in 1966, was the last of the major reform cases decided by the supreme court prior to *MacFadden*. In the course of its decision,[54] the court enunciated an important dictum that discussed the arguments of the amicus curiae, Professor Hetland.[55] In their briefest form, these arguments suggested that since an installment land sale contract is similar in economic effect to a mortgage and deed of trust, similar remedies should be available. The appropriate remedy would then be a judicial sale rather than a calculation of damages and restitution. Although the court felt no need to decide the issue its discussion serves as a warning of possible future action.[56]

III. IMPLICATIONS OF MACFADDEN

The extent of acceptance of Professor Hetland's views became apparent with the *MacFadden* decision. The most obvious implication

53. See text and citations accompanying notes 57-75 *infra*.

54. The court held the vendor could choose between rental value and Civil Code section 3307 difference value as his measure of damages in calculating restitution to the vendee on a cancelled land sale contract. 64 Cal. 2d at 803-04, 415 P.2d at 835, 52 Cal. Rptr. at 20. *See* HETLAND § 3.66.

55. Amicus curiae urges that the remedies for breaches of land-sale contracts should be reconsidered in the light of the distinct purposes such contracts serve. He points out that remedies that are appropriate for the breach of a buy-sell or marketing contract may not be appropriate for the breach of an installment contract entered into primarily as a security device. Since rules precluding forfeitures and anti-deficiency legislation have put the latter type of contracts substantially on a par in many respects with mortgages and deeds of trust, amicus curiae suggests that the law governing those security devices should be adopted with appropriate modifications in determining the remedies for breaches of installment contracts. On the vendee's breach, neither the vendee nor the vendor would have an election to rescind the contract, on the ground that rescission in effect converts a debt secured by the property in a lease of the property, a result not contemplated by either of the parties. In his view, the appropriate remedy is a judicial sale of the property, which will afford the vendor the benefit of his bargain to the extent not precluded by the prohibition against deficiency judgments (Code Civ. Proc., § 580b) and return to the vendee any excess of his part payments over the damages caused by his breach.

In the present case, however, the vendor is not seeking to rescind the contract, and neither party seeks a judicial sale of the property to fix damages. *Under these circumstances it is unnecessary to consider possible alternatives to the remedy recognized in the Barkis, Baffa, and Freedman cases of quieting the vendor's title on condition that he refund the excess, if any, of the payments received over the amount necessary to give him the benefit of his bargain.*

64 Cal. 2d at 804-05, 415 P.2d at 835-36, 52 Cal. Rptr. at 20-21 (emphasis added). Amicus curiae participated upon the invitation of Chief Justice Traynor. *Id.* at 802, 415 P.2d at 834, 52 Cal. Rptr. at 19.

56. *See* HETLAND § 3.67.

of *MacFadden* is the establishment of the distinction between the long-term installment contract and the marketing device contract.[57] This distinction is essential if the reform of land sale contracts is to bring equity rather than chaos.[58] The court made clear that an installment contract was involved;[59] its analysis was unmistakably in installment terms. And although the court did not expressly limit its holding to installment cases, it added the proviso that specific performance would be granted in "proper cases."[60] This language indicates that *MacFadden* is limited to installment contracts where the vendee has substantially performed under the contract or has made significant improvements on the property. Thus, limited, *MacFadden* concretizes the long-needed distinction between marketing device and security device land contracts.[61]

More complex implications of *MacFadden* that follow from the distinction between marketing and security contracts arise from Professor Hetland's arguments[62] and the court's implicit acceptance of them. Professor Hetland's basic tenet is that there is a distinction, in function and purpose, between a land sales contract that is used as a marketing device and one that is used as a security device.[63] The consequences that flow from this distinction, both remedially and procedurally, are already significant,[64] and the distinction forms the rubric under which Professor Hetland explains and catalyzes the reform in land sale contract law.[65]

Professor Hetland urged the *MacFadden* court to continue to equate the land contract security device to the other security devices, the mortgage and deed of trust.[66] As a result of this equation the

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57. The term "marketing device contract" includes deposit receipts, escrow instructions, and executory contracts for the purchase and sale of land. The parties to this type of contract, which evidences their buy-sell agreement, have the same kind of remedies as parties to any other kind of purchase contract. HETLAND § 3.59. Once the buyer takes possession and the parties intend to secure the purchase price by contract over a period of time, there are several remedial consequences. These include the operation of antideficiency protection and the unavailability of specific performance against the vendee. *Id.* *See* Hetland, *The California Land Contract, supra* note 4, at 729-30, 759-60.

58. *See generally* HETLAND § 3.59; Hetland, *The California Land Contract, supra* note 4, at 729-30, 759-60.

59. 5 Cal. 3d at 811, 488 P.2d at 1353, 52 Cal. Rptr. at 537.

60. *Id.* at 814, 488 P.2d at 1356, 52 Cal. Rptr. at 540.

61. See citations in note 57 *supra.*

62. See notes 55-56 *supra,* and accompanying text.

63. *See, e.g.,* HETLAND § 3.59; Hetland, *Real Property and Real Property Security, supra* note 4, at 152-59.

64. *See* HETLAND § 3.59.

65. *See id.* at §§ 3.58-3.81; Hetland, *Real Property and Real Property Security, supra* note 4; Hetland, *The California Land Contract, supra* note 4.

66. Professor Hetland states, "There has been a trend in the California courts

crucial affirmative defense of a forced judicial sale *would* be available to the defaulting vendee under a land sale contract.[67]

The *MacFadden* court was not presented with the issue of whether the willfully defaulting vendee should be able to impose a judicial sale on the vendor.[68] However, granting specific performance all but completed the remedial definition of an installment land contract as a mortgage by implicitly recognizing the vendee's equity of redemption, which is the right to pay off the debt and obtain thereby an unencumbered title.[69] Although this right has existed for centuries and has been recognized for vendees under mortgages and deeds of trust, and for nonwillfully defaulting vendees under land contracts,[70] *MacFadden* is the first authority binding on California state courts that recognizes it for willfully defaulting vendees under installment land contracts.[71]

Walker was allowed to exercise her equity of redemption in *MacFadden*. She was granted specific performance by paying the unpaid balance of the purchase price with interest. Under the facts of the case, technically she reinstated the contract by prepaying.[72] Despite the court's attempt to characterize this result in conventional equity and contract terms, the land sale contract was treated remedially as a security device.

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over the past two decades toward the total equation between the land contract and the mortgage. . . ." Letter to Chief Justice Wright, *supra* note 19, at 2. *See also* HETLAND § 3.59.

67. *See* HETLAND §§ 3.67-3.71. Forcing a judicial sale, argues Professor Hetland, is quicker, less expensive, and more accurately determines equitable distribution of the security, the property, than does restitution. *Id.*

68. 5 Cal. 3d 811, 488 P.2d 1353-54, 52 Cal. Rptr. 537-38. See text accompanying note 52 *supra* for *Ward's* dictum that a judicial sale may be compelled to protect the vendee.

69. HETLAND § 3.60.

70. *See* HETLAND § 3.60; Hetland, *The California Land Contract, supra* note 4, at 762-66.

71. *See* HETLAND § 3.60. The recognition of an equity of redemption does not necessarily mean the equation is complete in the sense that the vendee under an installment land contract has all of the rights as a mortgagor. For example, the right to pay off the obligation does not automatically include the right to force a judicial sale. *Id.* at § 3.74. Professor Hetland's comments concerning this equity of redemption bear repetition:

> A buyer's right to reinstate a contract he has willfully breached seems at first an extraordinary contract principle. But it is not a contract idea at all. Instead, the right to reinstate regardless of fault, i.e., *an unqualified equity of redemption,* is the usual right of the debtor in a secured transaction whether he is a mortgagor, a trustor, or a vendee under the installment (security) land contract. When the contract is used as a security device, security results should follow.

Id. at § 3.60 (emphasis added).

72. Under the contract Walker had the right to prepay. 5 Cal. 3d at 811, 488 P.2d at 1354, 52 Cal. Rptr. at 538.